

REBUTTAL TESTIMONY
OF
MARK A. HANSON

TELECOMMUNICATIONS DIVISION
ILLINOIS COMMERCE COMMISSION

AMERITECH ILLINOIS
DOCKET NOS. 98-0252/0335(CONSOL)

JANUARY 11, 2001

1

2 I. INTRODUCTION

3

4 **Q. Please state your name and business address.**

5 A. My name is Mark A. Hanson and my business address is 527 East Capitol Avenue,
6 Springfield, Illinois 62701.

7

8 **Q. Are you the same Mark A. Hanson who earlier sponsored testimony in this**
9 **proceeding?**

10 A. Yes.

11

12 **Q. What is the purpose of your rebuttal testimony?**

13 A. I will respond to comments made in the direct testimony of Harry Gildea on behalf of
14 the United States Department of Defense and All Other Federal Executive
15 Agencies. I will also respond to comments made in the direct testimony of William
16 Dunkel on behalf of Government and Consumer Intervenors. Also, I will respond to
17 the rebuttal testimony of Ameritech Illinois witnesses William Palmer, David
18 Gebhardt, David Sorenson, and Robert Harris.

19

20 II. LRSIC AND LOOP COST ISSUES

21 **Q. Have you had an opportunity to examine Ameritech Illinois' loop costing**
22 **model, LFAM?**

23 A. Yes. Commission Staff engaged a consulting firm, American Consultants
24 Alliance("ACA") to review the LFAM model. Staff witness Judith R. Marshall and I
25 accompanied the representatives of ACA to Ameritech Illinois facilities to test and
26 verify the model.

27 **Q. Did you, Ms. Marshall, or the ACA representative observe anything in the**
28 **course of this review which cause you to have any reservations regarding**
29 **the use of the LFAM model?**

30 A. Yes. The ACA representative and Staff found problems with the model operation.
31 We also formed the opinion that some of assumptions that are input into the model
32 do not conform with 83 Ill. Admin. Code Part 791.

33

34 **Q. What were the problems with model operations?**

35 A. The LFAM model has a series of screens that allow the user to change
36 assumptions about items such as cable length, material prices, and other factors.
37 The consultant attempted to modify the input screen on the fiber vs. copper break
38 assumption. When the user edits the screens to make changes to those input
39 items, the program should then update the Oracle database upon which the costing
40 analysis is performed. While testing alternate assumptions for fiberbreak length, the
41 ACA consultant retained by Commission Staff found that altering fiberbreak length
42 did not alter the results of the model. The consultant conferred with Ameritech
43 Illinois/SBC personnel to ensure that he was operating the model properly. The
44 consultant initially was informed that the changes he performed should work

properly. However Ameritech Illinois/SBC personnel attempted to modify the protocol using the same alternate assumptions as the consultant and they also found the model output results did not vary. Upon further investigation, the Ameritech/SBC personnel determined that there was an error in the Visual Basic code that was supposed to update the values in the Oracle database. Rather than the module updating the database with the value input by the user, the code contained a "hard-coded" value of 6000 feet for a break length between optical fiber and copper wire. Thus, regardless of value input by the model user, a value of 6000 feet would be carried to the database used for model operation.

Q. Do you have any concerns about this model problem?

A Yes. It raises questions as to whether the new model has been properly debugged.

Q. Have you identified any problems with the assumptions the model utilizes?

A. Yes. Ameritech Illinois is failing to take into account any reduction in material costs resulting from its merger with SBC.

Q. Would the merger with SBC result in material cost savings for Ameritech Illinois?

A. According to Ameritech Illinois, savings should result from the merger. Since LRSIC studies should incorporate forward looking costs, the prices for materials should reflect merger cost savings' impacts.

67

68 **Q. Do you have any other concerns with respect to LRSIC issues?**

69 A. Yes. Some responses to Staff data requests suggest further problems with
70 Ameritech Illinois' methods with respect to developing LRSIC. After Staff's
71 consultant completed his analysis of the LFAM system, Staff requested that the
72 Company run some additional scenarios on residential network access line LRSIC.
73 Although Ameritech Illinois did not respond to most of the requests, it provided four
74 of the requested scenarios. In examining the responses, I observed that there
75 appears to be an anomalous result that raises further questions about Ameritech
76 Illinois modeling of loop costs. Staff requested that the company perform a
77 sensitivity test where it used a fiber length break point of 12,000 feet rather than
78 6,000 feet. In Access Area A, this had the impact of lowering LRSIC from \$6.64 to
79 \$6.58. In another analysis, the Company ran a scenario using a cost of money of
80 10.52% and FCC depreciation rates. This set of assumptions had the impact of
81 lowering the LRSIC from \$6.64 to \$6.02 in Access Area A. However, in another
82 scenario, the Company provided for Staff the combination of changing the
83 fiberbreak point to 12,000, a cost of money of 10.52%, and FCC depreciation
84 rates. This scenario *raised* LRSIC from \$6.64 to \$6.68. This is very puzzling since
85 changing the components separately had the effect of lowering costs, yet when
86 combined had the effect of raising costs.. This illustrates either another problem
87 with the model, similar to its failure to properly revise its database described
88 earlier, or a problem in the loop cost modeling itself.

89 **Q. What is your recommendation based on your examination and the**
90 **examination conducted under your supervision?**

91 A. In my opinion, Ameritech Illinois has yet to establish that the its Loop Facility
92 Analysis Model is sound. In addition to the conceptual problems identified by Staff
93 witness Marshall in her rebuttal testimony, there have been instances of
94 assumptions that are critical to model operation that do not appear to work properly.
95 Also, there have been instances where unusual results occur when running
96 sensitivity analyses. If Ameritech Illinois estimates of LRSIC proved to be sound, I
97 might conceivably support rate rebalancing of residential network access line
98 charges. However, due to the problems outlined above, I believe it would be
99 premature for the Commission to allow Ameritech Illinois to raise network access
100 line charges in order to recover this purported deficiency in revenues to costs.
101 Therefore, there is no need to implement any of Ameritech Illinois' rate rebalancing
102 proposal.

103
104 **Q. Mr. Gebhardt contends that the embedded cost of service of providing**
105 **residential network access line service is \$19.12 on a statewide basis. In**
106 **your opinion, does this statement have merit?**

107 A. No. Illinois Cost of Service rules do not envision using embedded cost of service for
108 rate design. Besides, I do not find providing the embedded cost of service of one
109 service to be very useful analysis. If Mr. Gebhardt would provide the embedded
110 cost of service for products such as call waiting, caller ID, call forwarding, local

usage, etc. and contrast those figures with the rates for those services, an embedded cost of service analysis might have some value. Otherwise, the analysis of providing the embedded cost of service for network access lines in isolation is of little value and should be disregarded.

Q. Mr. Dunkel states that Ameritech Illinois has improperly included shared costs in its testimony concerning network access line charges. Do you agree? Please explain why or why not.

A. I agree with Mr. Dunkel's statement. As I stated in my direct testimony, it appeared that Ameritech Illinois has improperly included shared costs in its calculation of the LRSIC for residential network access lines, contrary to 83 Ill. Admin. Code Part 791. I support Mr. Dunkel's conclusions. I share Mr. Dunkel's belief that Ameritech Illinois has simply allocated overhead costs to the loop and is improperly calling them shared costs.

Q. Mr. Dunkel states his belief that loop costs should be treated as a shared cost rather than as a directly assigned cost to basic local service. Do you agree? Please explain why or why not.

A. No, I don not agree with Mr. Dunkel. Loop costs are service specific. The loop cost does not change with local usage, number of vertical services subscribed to, or number of toll calls placed. Therefore it is appropriate to recover the cost through a monthly charge. To do otherwise would be inconsistent with Code Part 791.

133

134 III. RESPONSES TO HARRY GILDEA'S DIRECT TESTIMONY

135 **Q. Do you agree with Mr. Gildea's support of Ameritech Illinois' rate**
136 **rebalancing proposal? Please explain why or why not.**

137 A. I do not agree with Mr. Gildea's analysis. As I stated in my direct testimony, I
138 do not support Ameritech Illinois' rate rebalancing proposal. In fact, the
139 rationales advanced by Mr. Gildea in support of rebalancing actually supports
140 my position. As Mr. Gildea states, it is highly unlikely that Ameritech Illinois' rate
141 rebalancing proposal will be revenue neutral. Rather, it is likely that the
142 proposal would result in increased revenues to Ameritech Illinois. Yet, after
143 pointing out that deficiency, Mr. Gildea nonetheless supports the proposal.
144 Contrary to Mr. Gildea's assertions, the Commission should not support a rate
145 rebalancing proposal that is almost certain to increase revenues for Ameritech
146 Illinois. Such a proposal is not a true rebalancing of rates.

147

148 **Q. Mr. Gildea also contends that raising residential network access line charges**
149 **is appropriate since they are lower than business network access line**
150 **charges and the costs of providing the two services are the same. Do you**
151 **agree? Please explain why or why not?**

152 A. I do not agree with Mr. Gildea regarding this issue. The fact that business and
153 residential network access line charges are different even though costs may be
154 similar is not sufficient reason to justify equating the prices. Although the price of a

155 service should generally cover the incremental costs of providing the service, this
156 does not mean that the charges for services having the same costs must be equal.
157 Costs are not the sole factor used to determine prices for non-competitive services.
158 The Commission must also account for universal service and equity considerations
159 when evaluating changes in prices for network access lines. Mr. Gildea does not
160 appear to take these factors into account in his analysis and consequently the
161 Commission should reject it.

162
163
164 IV. AMERITECH ILLINOIS REVISED RATE REBALANCING PLAN

165 **Q. What is the purpose of this section of your testimony?**

166 A. I will address some of the issues raised in the rebuttal testimony of Ameritech Illinois
167 witnesses Sorenson and Gebhard with respect to Ameritech Illinois' rate
168 rebalancing proposal.

169
170 **Q Mr. Sorenson states that you "support an increase in the residential network**
171 **access line price in Access Areas B and C to raise those prices to LRSIC". Is**
172 **that correct?**

173 A. No. Mr. Sorenson does not correctly summarize my position. In my direct testimony, I
174 only supported increases in network access line prices to the extent that such
175 increases in rates would be necessary to cover the LRSIC of the service. As I
176 described above, Ameritech Illinois has not, in my opinion, provided adequate

support for those LRSIC's. I do not believe that any increase in network access rates is necessary or proper at this time.

Q. Is the modified rate rebalancing proposal provided by Mr. Gebhardt and Mr. Sorenson in their testimonies adequate?

A. Although the rate rebalancing modifications Mr. Gebhardt and Mr. Sorenson make in their testimonies are improvements over the original, there are still numerous defects in the overall proposal. Most significant among these defects is the fact there is no need for rate rebalancing in the first place. However, in order to complete the record, I will address some of the other defects in Ameritech Illinois' revised rate rebalancing proposal.

Q. In your direct testimony, you stated that Ameritech Illinois' rate rebalancing proposal would not result in a revenue neutral outcome because of demand effects. Has Ameritech Illinois addressed this issue in its rebuttal testimony?

A. Yes. In response to comments Mr. Gildea and I made regarding the proposal, myself, Mr. Sorenson of Ameritech Illinois has updated Ameritech Illinois rate rebalancing proposal to account for demand effects.(Ameritech Exhibit 9.1, at 3).

198 **Q. In Ameritech Illinois' new proposals, the company states that if demand**
199 **impacts are taken into account, then the LRSIC of the incremental units**
200 **should be accounted for in assessing the impact of the change. Do you**
201 **agree?**

202 A. This seems to be reasonable. I have no objection to this change. This is an
203 improvement over Ameritech Illinois' initial rate rebalancing proposal, but, as I
204 observed, the proposal still has defects.

205
206 **Q. What are some of those defects?**

207 A. It is not appropriate for the company to offset any network access line rate increase
208 to end users by the access charge reductions to IXCs ordered by the Commission
209 in Docket Nos. 97-601/602 (Consol.). As the Commission stated in its Order in that
210 proceeding:

211 "We are not, however, required to institute a new mechanism by which Ameritech
212 may offset any access revenue decreases by increasing other rates. In fact, in our
213 Phase I order in this docket, we rejected Ameritech's revenue neutral methodology
214 for calculating and implementing its intrastate PICC, instead adopting the IXC
215 mirroring methodology. Given the rates of return reported by Ameritech, which are a
216 matter of record in this proceeding, we are convinced that any reduction in access
217 revenues experienced by Ameritech will not impact its overall financial viability.
218 Indeed, we agree with Staff witness Ms. Yow that the increased demand for toll
219 services that will almost certainly occur as a result of lower access charges may be

220 sufficient to offset-or go a long way to offsetting - any revenue loss from reducing
221 access charges. "(Final Order, Docket No. 97-0601, at 52)

222 Further on in the Order the Commission states:

223 "We likewise reject Ameritech's proposal in this proceeding to recover any access
224 reductions by increasing its NAL rates. We agree with AT&T witness Conway that
225 this proposal is better addressed in the context of Ameritech's rate rebalancing
226 docket (ICC Docket No. 98-0355) where Ameritech can update its LRSIC studies.
227 The Commission can then determine whether such increases are warranted in light
228 of the fact that Ameritech's NAL's are already priced above LRSIC and the fact that
229 Ameritech's residential NAL rates are currently capped as a result of its alternative
230 regulation plan." (Id., at 53)

231 In the rate rebalancing plan proposed in this proceeding, Ameritech Illinois has not
232 shown that its overall financial viability is compromised as a result of the reduction,
233 nor has it addressed any issues regarding increased demand for toll services.
234 Additionally, given the problems with Ameritech Illinois' revised network access line
235 LRSIC that I have identified elsewhere in my testimony, it does not appear that
236 Ameritech Illinois has established that the revenues it receives from providing
237 network access line revenues are less than LRSIC. The company has not
238 established any reason why the access charge reductions ordered in Docket No.
239 97-0601 should be used to justify an increase in network access line charges.

241 **Q. In your direct testimony, you stated that Ameritech Illinois has failed to**
242 **account for its volume discounts when developing its rate rebalancing**
243 **proposal. Did Ameritech Illinois correct that problem in its revised rate**
244 **rebalancing proposal?**

245 A. No. Mr. Sorenson does mention the effect of volume discounts when discussing
246 some of Mr. Dunkel's proposed rate reductions but does not incorporate them into
247 his rate rebalancing proposal. This is a defect in his proposal. Not including those
248 effects overstates the revenue reduction of Band B usage by \$2,232,846. .

249
250 **Q. Mr. Sorenson takes issue with your statement that Ameritech Illinois**
251 **understated by \$0.11 the amount of revenue it collects from residential**
252 **network access lines. What is your reaction to his statement?**

253 A. Even though Ameritech Illinois is recovering the revenue from a subsidy, nonetheless
254 it is recovering the revenue. Also, effective on July 1 of this year, the EUCL will be
255 raised to \$4.46 so that Ameritech Illinois will then recover that \$0.11 in revenue
256 directly from the customer. \$4.46 is the proper amount of revenue generated by the
257 EUCL charge.

258
259 **Q. Mr. Sorenson contends that Residential Band A usage should not be used**
260 **to offset increases in network access line charges. Do you agree? Why or**
261 **why not?**

262 A. I do not agree. To the extent that rate rebalancing is necessary, Band A usage
263 remains the best way to offset the increases. Ameritech Illinois has not made any
264 proposal regarding how to best offset its proposed increases in residential network
265 access line charges. Ameritech Illinois' proposal does not appear to be based on
266 any principle other than maximizing revenues from customers who do not have
267 service alternatives to Ameritech Illinois. This may be a desirable outcome for
268 Ameritech Illinois but I do not believe it is in the best interest of its customers. Any
269 rate rebalancing proposal should take into account the standards articulated in the
270 Public Utilities Act. Section 1-102 of the of Public Utilities Act states "that the goals
271 and objectives of such regulation shall be to ensure (a) Efficiency ...(b)
272 Environmental Quality ...(c) Reliability ...(d) Equity." Using residential Band A usage
273 rate reductions to offset network access line rate increases would meet the
274 efficiency standard if the proposed Band A rates covered LRSIC. Reducing
275 residential Band A usage rates would also meet an equity standard since the group
276 of customers impacted negatively by network access line rate increases would
277 receive positive impacts from the Band A usage rate reductions.

278
279 **Q. Mr. Sorenson contends that the duration of a Band A call has increased**
280 **since the LRSIC studies so that the rate reduction Mr. Dunkel would result**
281 **in rates that are below cost. Do you concur in this statement?**

282 A. I cannot concur in, or take issue with, this statement, since Mr. Sorenson has not
283 provided adequate support for it. However, Mr. Sorenson's testimony does seem to

contradict Mr. Van Lieshout's statement in his direct testimony (Ameritech Exhibit 9.0, at 11, lines 4-8,) that margins on usage have been increasing. Accordingly, in the absence of further evidence on this point, the Commission should disregard Mr. Sorenson's position.

Q. Have you prepared an alternate rate rebalancing proposal?

A. No, I have not. In my direct testimony, I prepared an alternate rate rebalancing proposal. However, since I now believe that rate rebalancing is unnecessary, I have not prepared an alternate proposal.

V. RATE REDUCTION SCENARIOS

Q. What is the purpose of this section of your testimony?

A. First of all, the Staff's position does not support reinitializing rates nor does it advocate a return to rate of return regulation. However, should the Commission elect to consider either of those options, I will comment on Mr. Dunkel's testimony on those issues. I will also comment on the testimony of Mr. Sorenson and Mr. Palmer on behalf of Ameritech Illinois. I will offer alternate rates to Mr. Dunkel's proposed rates based on the three scenarios presented in my direct testimony. Again, I present these options for use by the Commission should it elect to consider either rate reinitialization, or returning the Company to rate of return regulation. The Staff does not advocate either of these outcomes, but rather modification of the existing plan going forward.

306

307 **Q. Do you have any other comments on your alternate rates?**

308 A. Yes. Like Mr. Dunkel, I use 1999 usage figures to calculate rate levels. By the time
309 this proceeding concludes, Ameritech will have available year 2000 usage figures
310 since it must assemble that data for its annual Aggregate Revenue Test filing.
311 Should the Commission decide to reset rates, it should direct Ameritech Illinois to
312 calculate rates based on the year 2000 usage figures.

313

314 **Q Mr. Dunkel proposes a wide variety of rate cuts in usage, vertical services,**
315 **and calling plans, among others. What is your opinion of these proposals?**

316 A. Using a revenue requirements type of analysis to re-initialize rates or return to rate of
317 return regulation will effectively mean that the rates for almost all non-competitive
318 services will be driven down to LRSIC levels. Generally, it is my opinion that usage
319 rates for individual services should be reduced first, then usage rates in calling
320 plans, and finally vertical and other services.

321

322 **Q. Mr. Dunkel proposes eliminating the charges for non-published and non-**
323 **listed numbers. Mr. Sorenson is opposed to this on the basis that these**
324 **charges serve as a disincentive to customers choosing to not have their**
325 **phone numbers published or non-listed. What is your opinion on this?**

326 A. Since the LRSIC of these services is basically zero, eliminating the charge for them
327 would be appropriate in a situation where revenue reductions are being sought.

328 Although there may be some minimal social value to having a comprehensive set of
329 listings available, that certainly does not warrant keeping this charge in place should
330 the Commission find it necessary to reduce rates.

331

332 **Q. Mr. Dunkel recommends reducing Band A usage charges. Mr. Sorenson is**
333 **opposed to this. What is your opinion?**

334 A. Reducing Band A usage charges is an appropriate method of reducing revenue
335 requirements for the reasons I mentioned earlier in my comments on rate
336 rebalancing. Attachment 28.01 contains my specific rate reduction proposals for
337 Band A usage.

338

339

340 **Q. Mr. Dunkel proposes reducing charges on business network access line,**
341 **business local usage, and business vertical service rates. Do you agree?**

342 A. No. As I stated in my direct testimony, ordering rate reductions on competitive
343 services would have very little effect since Ameritech Illinois can raise the rates for
344 any competitive service on one day's notice. It would be difficult to sustain any
345 revenue requirement reduction that would result from those rate reductions. These
346 rates should not be reduced.

347

348 **Q. Mr. Dunkel suggests that residential vertical feature prices should be**
349 **reduced in order to reduce Ameritech Illinois revenues. Mr. Sorenson states**

that even though the margins on those services are large, their prices should not be reduced since customers place high value on the services.

What is your opinion?

A. Should the Commission decide to reduce Ameritech Illinois revenue requirements, reducing residential vertical feature prices would be appropriate. These are non-competitive services with large margins so that prices may be reduced and leave substantial contributions to shared and common costs. Mr. Sorenson states that since customers place a high value on these services the price should not be reduced. However, I am confident that a substantial price reduction in these services will not diminish the value customers derive from them. Attachment 28.01 contains the specific rate reductions in these services that I am proposing.

Q. Do you have a summary of your proposed rate reductions?

A. Yes, Attachment 28.01 contains my specific rate reductions for each of my three scenarios. I also include the projected revenue requirement reduction for the rate decreases.

VI. RESPONSES TO DR. HARRIS' TESTIMONY

Q. Dr. Harris cites your testimony as an example of "low contribution margin theory" since you propose pricing network access line charges at LRSIC. What is your reaction to Dr. Harris' comments?

372 A. In my opinion, it is inappropriate to characterize my proposal on pricing network
373 access line services as in any way theoretical. I am reacting to the specific
374 circumstances in this proceeding that impact network access line rates and costs.
375 Under price regulation, services generally should decline in price through time on a
376 real (inflation-adjusted) basis. However, Ameritech Illinois is proposing very
377 substantial increases in network access line charges on the order of 30-50%
378 because of the purported increase in forward-looking costs of providing those
379 services. As Mr. Palmer states in his direct testimony:
380 "Some non-competitive services have negative margins or barely recover their
381 direct LRSIC costs, while other non-competitive services have contribution levels of
382 over 100%. Again, the wide variance in contribution levels does not necessarily
383 mean that a low margin of service is under recovering and a high margin service is
384 "over-recovering." All the variance in contribution levels means, absent some
385 LRSIC-plus pricing formula, is that some services are contributing more than others
386 to the recovery of Ameritech Illinois' actual costs. However, services which do not
387 even cover their LRSIC costs(including shared costs) should be clearly evaluated for
388 repricing." (Ameritech Illinois Exhibit No. 10.0, at 5-6).

389 To suggest, as Dr. Harris does, that setting two rates equal to LRSIC (network
390 access line charges for Access Area B and C) amidst a multitude of rates returning
391 several thousand percent contribution over LRSIC constitutes a "low contribution"
392 theory is at best questionable.

394 **Q. Your preferred scenario in the revenue requirements reduction scenario**
395 **contemplates setting all or almost all non-competitive rates to zero.**
396 **Wouldn't this constitute the "low contribution" theory Dr. Harris suggests?**

397 No, it does not. Again, this is based on the specific set of circumstances in this
398 proceeding. Staff recognizes that there is a problem with reducing non-competitive
399 rates to LRSIC and that is why I have proposed other revenue requirement reduction
400 scenarios. This is also a reason why resetting rates is not the Staff's preferred
401 option.

402
403
404 **Q. Does this conclude your rebuttal testimony?**

405 **A.** Yes, it does.
406
407